CHAIRMAN'S STATEMENT

BUSINESS REVIEW

The audited consolidated revenue of the Group for the year 2006 was RMB9,782 million, representing an increase of 6.5% as compared to that of 2005, while the audited profit attributable to equity holders of the Company was RMB1,033 million, representing an increase of 22% from that of 2005. The audited basic earnings per share for the year 2006 was RMB0.36, representing an increase of 24.1% from that of 2005.

In 2006, the Group's total sales volume was 3,746,201 tonnes (2005: 3,335,805 tonnes), representing an increase of 12.3%. In 2006, billets, strips and strip-related products, H-section steel, cold rolled sheets and galvanised sheets accounted for 31.3%, 58.8%, 6.6%, 1.2% and 2.1% of the Group's total sales volume respectively (2005: accounted for 43.7%, 55.4%, N/A, 0.9% and N/A respectively), indicating further optimisation of the Group's sales mix.

The Group's average selling prices of billets and strips and strip-related products as well as H-section steel products (excluding value-added tax) were RMB2,347 per tonne, RMB2,600 per tonne and RMB2,917 per tonne respectively in 2006, representing decreases of 5.8%, 10.9% and N/A when compared to RMB2,491 per tonne, RMB2,917 per tonne and N/A in 2005. In February 2007, the unaudited average selling prices of billets and strips and strip-related products as well as H-section steel products (excluding value-added tax) were RMB2,505 per tonne, RMB2,750 per tonne and RMB3,195 per tonne respectively.

The average costs of sales of the Group's billets and strips and strip-related products as well as H-section steel products in 2006 were RMB1,963 per tonne, RMB2,155 per tonne and RMB2,629 per tonne respectively, representing decreases of 13.3%, 11.5% and N/A when compared with RMB2,264 per tonne, RMB2,436 per tonne and N/A in 2005 respectively. The decline in the average costs of sales per tonne was mainly due to lower average purchasing prices of iron powder and coke in 2006 when compared with those in 2005.

In 2006, gross profits of billets and strips and strip-related products as well as H-section steel products were RMB384 per tonne, RMB445 per tonne and RMB288 per tonne respectively (2005: RMB227 per tonne, RMB481 per tonne and N/A respectively).

Owing to the increase in total sales volume in 2006 and a relatively small decline in the selling price of billets, the gross profit in 2006 increased by 16.4% from that of 2005 to RMB1,424 million (2005: approximately RMB1,224 million).

AWARDS TO THE COMPANY AND THE MANAGEMENT

Hebei Jinxi Iron and Steel Company Limited ("Jinxi Limited"), a subsidiary of the Group, and Mr. Han Jingyuan, the Chairman and the Chief Executive Officer of the Company, were named as the "2005 Top Ten Most Influential Brands in China" and "Top Ten Outstanding Entrepreneurs in Brand Building" respectively by the China Enterprise Culture Improvement Association, China Industrial Design Association and Market Daily of the People's Daily as well as China Quality and Brand Magazine in January 2006.

In May 2006, Jinxi Limited ranked 12th out of the top 100 enterprises in Hebei Province at the Sixth "Top 100 Enterprises" held in Hebei Province.

On 19 August 2006, the National Bureau of Statistics of China announced that Jinxi Limited ranked 168th out of the top 500 manufactures in the Chinese manufacturing industry.

Jinxi Limited was named as an "Enterprise with an AAA credit rating in quality" by China Product Quality Association and named as the "Enterprise Recognised for User Satisfaction in Hebei Province" by the Association for Quality of Hebei Province in November 2006.

In December 2006, the Ministry of Commerce of the People's Republic of China announced a list of the 500 largest foreign investment companies for the year 2005/2006. Jinxi Limited ranked 87th on the list, and was the second largest out of 14 enterprises from Hebei Province named on the list.

Mr. Han Jingyuan was also named the "Best Entrepreneurs in China" (Fifth Edition) by China Enterprise Confederation, China Enterprise Directors Association and other organisations in April 2006.

The Hebei Entrepreneur Association named Mr. Han Jingyuan as an "Excellent Private Entrepreneur in Hebei Province" on 18 August 2006.

HUMAN RESOURCE AND REMUNERATION POLICIES

As at 31 December 2006, the Group had a workforce of 6,052 (31 December 2005: 5,224) and temporary staff of 2,150 (31 December 2005: 1,906). Staff cost of the Group for the year 2006 was approximately RMB243 million (2005: approximately RMB169 million), representing an increase of 44.4%. The staff cost included basic salaries and benefits, as well as staff benefits such as discretionary bonus, medical and insurance plans, pension scheme, unemployment insurance plan, maternity insurance plan, fair value of share option etc. The Group's remuneration policies are designed to tie its employees' income to their productivity and/or sales volume, as well as to the extent they meet the Group's quality control and cost control targets. To enable the directors and employees of any of the Group's subsidiary or invested entity to have the opportunity for acquiring a shareholding in the Company and to encourage them to strive for enhancing the value of the Company and its shares for the benefit of the Company and its shareholders as a whole, the Company adopted a share option scheme on 23 June 2006. In order to improve the Group's productivity and further enhance the quality of its workforce, the Group provided continuing education and training programmes to both the management staff and factory workers.

PRODUCTION CAPACITY

The annual production capacity of the Group as at the following dates was:

	31 December 2006 *(tonnes)*	31 December 2005 *(tonnes)*
Billets	**4,000,000**	4,000,000
Strips	**1,600,000**	800,000
Mid-width strips	**1,200,000**	1,000,000
H-section steel products	**1,000,000**	—
Cold rolled sheets and galvanised sheets	**250,000 — 400,000**	250,000 — 400,000

H-SECTION STEEL ROLLING LINE

The production line of H-section steel products, with an annual production capacity of 1 million tonnes of H-section steel products, commenced trial production in May 2006 and commercial production in late August 2006.

In 2006, the Group produced 473,164 tonnes of H-section steel products, with the sales volume of approximately 249,911 tonnes. The sales revenue and cost of sales generated from approximately 131,897 tonnes of H-section steel produced prior to the end of the trial production in late August 2006 had been recognised as the costs of H-section steel project in accordance with the relevant accounting standards.

The export sales of H-section steel in 2006 accounted for approximately 9.5% of the above-mentioned sales volume and the sales volume that had been carried over to project costs.

INVESTMENT IN FOSHAN JIN XI JIN LAN COLD ROLLED SHEET CO., LTD. ("FOSHAN JINXI")

In 2006, the Group sold 44,814 tonnes of cold rolled sheets and 76,869 tonnes of galvanised sheets respectively (2005: 30,578 tonnes and N/A respectively).

In 2006, the average selling prices of the Group's cold rolled sheets and galvanised sheets (excluding value-added tax) were RMB3,578 per tonne and RMB4,959 per tonne respectively (2005: RMB3,831 per tonne and N/A respectively).

In February 2007, the unaudited average selling prices of the Group's cold rolled sheets and galvanised sheets (excluding value-added tax) were RMB3,807 per tonne and RMB5,134 per tonne respectively.

Pursuant to prudent principles, the Group, during the year, made a provision for assets impairment of approximately RMB41.859 million for Foshan Jinxi's property, plant and equipment.

Due to a decline in the profit margin in the product market of Foshan Jinxi, intensified market competition and production, the audited annual loss, after taking into account of the above-mentioned provision for assets impairment, of Foshan Jinxi was approximately RMB91.252 million (2005: RMB51.613 million).

Following the commercial production of Foshan Jinxi's galvanised production line, with an annual capacity of 150,000 tonnes in August 2006, Foshan Jinxi's competitiveness and product mix will further be enhanced. Foshan Jinxi will continue to fine-tune its production process, improve its production efficiency and product mix as well as actively expand the market.

DIVIDEND POLICY

The Company intends to distribute not less than 20% of the Group's distributable profit as dividend for the periods subsequent to its listing, but the actual amount of dividend and its percentage to the profit will be at the discretion of the Board and will depend upon the Company's future operation and earnings, capital requirement and surplus, general financial condition, contractual restrictions, and other factors that the Board deem relevant. In addition, pursuant to relevant PRC law, Jinxi Limited's distributable profit should not be higher than its net profit after allocations made to the statutory reserve as determined by the generally accepted accounting principles in the PRC.

CAPITAL STRUCTURE

The cash and bank balances (including restricted bank balances) of the Group as at 31 December 2006 was RMB530 million (31 December 2005: RMB1,725 million).

The current ratio was 1.55 as at the end of 2006 (31 December 2005: 1.22).

As at 31 December 2006, the Group's borrowings repayable within one year and borrowings repayable after one year amounted to approximately RMB573 million and RMB361 million respectively (31 December 2005: approximately RMB1,336 million and RMB294 million respectively).

The consolidated interest expenses in 2006 amounted to RMB50.387 million (2005: RMB74.189 million). The interest coverage was 25.5 times (2005: 14.5 times).

As at 31 December 2006, the ratio between total liabilities and total assets of the Group was 31.9% (31 December 2005: 42.0%).

To conclude, the financial position of the Group was healthy.

CAPITAL COMMITMENTS

As at 31 December 2006, the Group had capital commitments amounted to RMB2,070 million (31 December 2005: RMB256 million), which mainly consisted of the capital commitments to the construction of the H-section steel rolling line with annual production capacity of 1.2 million tonnes and other ancillary projects. Based on preliminary estimate, such capital commitments will be financed by the Group's internal resources and/or bank borrowings.

GUARANTEES AND CONTINGENT LIABILITIES

As at 31 December 2006, the Group's contingent liabilities amounted to RMB69 million (31 December 2005: RMB277 million), which mainly consisted of the guarantees for the letter of credit issued by an agent appointed by the Group to import machinery and equipment on behalf of the Group.

PLEDGE OF ASSETS

As at 31 December 2006, the net book value of the Group's property, plant and equipment amounting to approximately RMB1,088 million (31 December 2005: approximately RMB568 million), land use rights amounting to approximately RMB65 million (31 December 2005: approximately RMB67 million), inventories amounting to approximately RMB69 million (31 December 2005: approximately RMB32 million), notes receivable amounting to approximately RMB174 million (31 December 2005: approximately RMB67 million) and restricted bank balances amounting to approximately RMB95 million (31 December 2005: approximately RMB1,016 million) had been pledged as security for the Group's banking facilities.

PLEDGE OF ASSETS *(Continued)*

As at 31 December 2006, Jinxi Limited pledged approximately RMB51 million of its notes receivable as security for providing guarantees so as to facilitate the issuing of letter of credit by a third party acting as its agent to import plant and equipment for Jinxi Limited (31 December 2005: approximately RMB248 million).

EXCHANGE RISKS

As at 31 December 2006, Renminbi, US dollar and HK dollar accounted for 75.9%, 23.7% and 0.4% of the Group's total bank balances (including restricted bank balances) respectively (31 December 2005: 28.9%, 71.0% and 0.1% respectively).

As majority of the sales, purchases of raw materials and bank loans committed by the Group were mainly in Renminbi in 2006 and 2005, the Group's exposure to foreign exchange risk remained relatively low. In light of the construction of the H-section steel rolling line, the Group had entered into project and equipment contracts in Euro Dollar of approximately Euro42.9 million. In 2005, the Group has entered into Euro Dollar forward contract to hedge against partial exchange rate risk exposure.

INTEREST RATE RISKS

The interest rates of the Group's certain borrowings are subject to variations. The risk of increasing interest rate will increase the interest costs of both new borrowings and existing borrowings. At present, the Group does not use any derivatives to hedge its interest rate risk exposure.

POST BALANCE SHEET EVENTS

Saved as disclosed in this report of the Group, there are no events to cause material impact on the Group from the balance sheet date to the date of this report.

PROSPECTS

In the coming year, with favourable factors including continuous economic growth in the PRC and the government's continued elimination of backward capacity of iron and steel, the domestic price of iron and steel will continue to be supported by the relatively higher prices of iron and steel in overseas markets and surging raw material prices. However, increase in the supply of iron and steel in the industry as well as the uncertainty over the government's introduction of other macroeconomic austerity measures (for example, a further downward adjustment to export tax rebate) will rein in the rise in the price of iron and steel.

In the face of an intensified market competition, the Group will continue to keep an eye on the market and improve its product mix and enhance its production efficiency. Following the commercial production of the H-section steel rolling line and the strip production line with an annual production capacity of 600,000 tonnes in late August 2006, the Group will be able to further fine-tune its product mix.

With regard to raw material, the increase in production capacity in the iron and steel industry will drive the demand for both domestic and imported iron powder in the PRC. As such, it is expected that the price of iron powder will continue to fluctuate at a high level. In early March 2007, the purchasing price of domestic iron powder (including value-added tax) was approximately RMB780 per tonne.

On the front of coke, owing to the frequent accidents in coal mines, rise in coal price and strained railway transportation, the coke price will also fluctuate at a high level. In early March 2007, the purchasing price of coke (including value-added tax) was approximately RMB1,250 per tonne.

On Behalf of the Board
China Oriental Group Company Limited

Han Jingyuan
Chairman and Chief Executive Officer

Hong Kong, 3 April 2007